Arizona State Senate
Issue Brief

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Note to Reader:

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MUNICIPAL BUSINESS TAX INCENTIVES

INTRODUCTION

There are three categories of business tax incentives employed by local governments: infrastructure development, economic revitalization and economic development.

In Arizona, much of the debate regarding municipal tax incentives has centered on municipalities offering an incentive to businesses that would likely develop in the local area regardless of any incentive offered.

Infrastructure Development

Tax incentives may be offered in exchange for a developer paying the initial costs of public infrastructure construction. Arguments in favor of this type of incentive suggest that it can be more cost effective for the taxpayers as there are no initial costs for the municipality or interest payments resulting from bond financing. Additionally, developers may have more flexibility with the timing of a project if they are responsible for the infrastructure, rather than being dependent on a municipality's timetable.

Tax incentives may also be provided to existing businesses that are impacted by public infrastructure improvements. Street widening or realignment projects can temporarily or even permanently impact an existing business' street access, customer visibility or expansion potential. Tax incentives can be provided to offset the cost to the business for things such as street entrance, parking lot or signage modifications needed to adjust to the public infrastructure changes.

Economic Revitalization

Tax incentives are used in blighted or declining areas to allow local businesses to reinvest the tax savings back into their business.

In theory, by encouraging reinvestment, the area is less likely to fall into further decline and more likely to improve. Tax incentives are sometimes offered to attract businesses to particular neighborhoods within a municipality. One example would be to offer a tax incentive to attract a supermarket to an economically depressed neighborhood.

Tax incentives are also used to encourage infill development. In most cases, land in outlying incorporated or unincorporated areas is more attractive because it is relatively unencumbered when compared to infill property, which can have multiple owners and many other obstacles such as ground contamination from previous or nearby uses or existing structures already on the property.

Economic Development

As previously mentioned, the largest criticism regarding tax incentives directed at municipalities is that, in some circumstances, they are offered to businesses that would locate in the area even if the tax incentives were not offered; especially when this results in neighboring cities engaging in bidding wars for a particular business.

However, proponents of tax incentives argue that in many instances a large-scale development or even a smaller business would not be built without an incentive. For example, many upscale retail stores limit their expansions and the awarding of a new location is a highly competitive process. The ability to offer a tax incentive can be the determining factor.

Tax incentives can also be used to foster the local development of businesses and jobs related to emerging markets. For example, the Arizona Bioscience Strategy plans to bring together a wide consortium of public and private entities involved in emerging technologies, such as the Translational Genomics Research Institute (Tgen). Proponents argue that creating a local base for the development of emerging technologies has tremendous economic potential. The location of such institutions is highly competitive with international competition in addition to the domestic. Once the base is created, the area becomes the logical location for future related institutions and industries to locate as the technology emerges.

Legislative Activity

Laws 2005, Chapter 200, requires a municipality to make a finding, by a two-thirds vote of the governing body in a municipality located in or within 25 miles of a metropolitan statistical area with more than two million persons, or by a simple majority in all other municipalities, without the use of consent calendar, before entering into a retail development tax incentive agreement. The finding must include both of the following: 1) that the proposed tax incentive is anticipated to raise more revenue than the amount of the incentive within the duration of the agreement and 2) that the retail business or a similar retail business would not locate in the municipality in the same time, place or manner without the tax incentive. The finding must be verified by an independent third party before the municipality enters into the retail development incentive agreement and the municipality must present a public status report of the revenues and expenses associated with the tax incentive every two years for the duration of the agreement.

The legislation also establishes the same vote requirement for the adoption of a retail development tax incentive agreement by a municipality and prohibits the use of an emergency measure. The municipality is prohibited from entering into a retail development tax incentive agreement if the proposed tax incentive will raise less revenue than the amount of the incentive.

Laws 2005, Chapter 105, prohibits a municipality from using an emergency measure on an action by the council involving an economic development expenditure or development agreement. An action taken on an economic development expenditure and development agreement becomes effective no sooner than 30 days after final approval.

ADDITIONAL RESOURCES

- League of Arizona Cities and Towns
  www.azleague.org
- Translational Genomics Research Institute
  www.tgen.org
- City of Phoenix
  www.phoenix.gov
- Arizona Department of Commerce
  www.commerce.state.az.us